CHAMPLIN PETROLEUM CO.

IBLA 86-259 Decided December 3, 1987

Appeal from a decision by the Acting District Manager, Rock Springs District Office, Bureau of Land Management, approving the Fourteenth, Fifteenth, and Sixteenth Revisions of the Nugget Formation "A" participating area within the Painter Reservoir Unit, Uinta County, Wyoming.

Set aside and remanded.

1. Oil and Gas Leases: Unit and Cooperative Agreements
The participating area established pursuant to a unit agreement may be revised to include additional lands then regarded as reasonably proved productive of unitized substances in paying quantities, or which are necessary for unit operations. Lands utilized for water injection wells may be added to the participating area if those wells improve recovery of unitized substances in the participating area, since those lands may be considered necessary for unit operations. However, where lands are added to a participating area on the basis that they are necessary for unit operations, the record on appeal must show a rational basis for that determination. Where it does not, the BLM decision to include certain lands will be set aside.

APPEARANCES: Kendor P. Jones, Esq., and Joseph D. Henry, Esq., Englewood, Colorado, for appellant; Donald H. Sweep, District Manager, Rock Springs District Office, Rock Springs, Wyoming, Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE HARRIS

Champlin Petroleum Company (Champlin) 1/ has appealed from a decision dated September 30, 1985, wherein the Acting District Manager, Rock Springs District Office, Bureau of Land Management (BLM), approved the Fourteenth, Fifteenth, and Sixteenth Revisions of the Nugget Formation "A" participating area within the Painter Reservoir Unit, Uinta County, Wyoming. Champlin

1/ Following the filing of this appeal, Champlin underwent a corporate name change. It is now known as Union Pacific Resources Company.

argues that these revisions to the participating area, which include the addition of tracts which the parties agree are nonproductive and are not underlain by unitized substances, violate section 11 of the Painter Reservoir Unit Agreement (Unit Agreement).

In an application received by BLM on August 19, 1985, Chevron U.S.A., Inc. (Chevron), requested approval of the Fourteenth, Fifteenth, and Sixteenth Revisions of the Nugget Participating Area "A" within the Painter Reservoir Unit. Therein, it explained:

> The proposed Fourteenth and Fifteenth Revisions are predicated upon the consideration that water injection into the Nugget Formation of the Painter Reservoir Field, Painter Reservoir Unit will result in improved hydrocarbon recovery, and therefore Participating Area "A" in the Painter Reservoir Unit should be revised to include the bottom hole locations, at the Nugget Formation Top, of water injection wells PRU 11-31B and PRU 32-30B.
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> The proposed Sixteenth Revision is in accordance with Sections 2(e) and 11 of the Unit Agreement, which state that legal subdivisions of land within the participating area shall be 40 acre tracts or the nearest aliquot equivalent thereof, and that the participating area may be revised to include additional land necessary for Unit operations, respectively. The Sixteenth Revision will allow surface locations of Nugget Formation wells within the Painter Reservoir Field, Painter Reservoir Unit to be included in the participating area and will establish the participating area on a 40 acre tract basis. 2/

Chevron proposed in the application that the lands constituting the Sixteenth Revision would not be entitled to participation in unitized substances from the Nugget Formation, and no royalty would be allocated to the lands, "since the basis of the Sixteenth Revision is not due to the addition of lands proved to be productive in paying quantities."

The proposed revisions were submitted for approval to the working interest owners, Champlin and Amoco Production Company, on June 27, 1985. By letter to Chevron dated July 16, 1985, Champlin stated the following objections to the proposed revisions:

2/ The Fourteenth Revision, as approved, includes 10 acres described as the SW 1/4 NE 1/4 NW 1/4, sec. 31, T. 16 N., R. 119 W., Painter Reservoir Field, Unita County, Wyoming. The Fifteenth Revision, as approved, includes 10 acres described as the SE 1/4 SE 1/4 NE 1/4 of sec. 30, T. 16 N., R. 119 W., Painter Reservoir Field, Uinta County, Wyoming. These areas represent the locations where the directionally drilled injection wells cross the top of the Nugget formation. The Sixteenth Revision, as approved, includes 765.74 acres in the Painter Reservoir Field, Uinta County, Wyoming.

> The lands in question are not known to be underlain by unitized substances and have never produced. Secondly, improved hydrocarbon recovery by water injection into the Nugget Formation beneath these lands is unmeasurable and certainly unproven. Finally, the inclusion of the lands in the Fourteenth and Fifteenth Revisions as participating acreage will set a harmful precedent to some royalty owners in the not unlikely event that additional water injectors could be drilled whose bottom hole locations at the Nugget Formation top are an even greater distance from the hydrocarbon-bearing portion of the reservoir.

Chevron submitted a copy of Champlin's objection letter to BLM with the application for approval of the proposed revisions.

The Rock Springs District Office approved Chevron's request by decision dated September 30, 1985. The Fourteenth and Fifteenth Revisions were approved effective December 1, 1983, and February 1, 1984, respectively, and the Sixteenth Revision was approved effective February 27, 1985. The Fourteenth and Fifteenth Revisions were approved pursuant to section 11 of the Unit Agreement, which provides that "a participating area shall represent the area known or reasonably proved to be productive of unitized substances in paying quantities or which are necessary for unit operations * * *." [Emphasis added.] BLM's decision simply states that the Fourteenth and Fifteenth Revisions are based upon the first injection of water into unit water injection well No. 11-31B, located in the area covered by the Fourteenth Revision, and well No. 32-30B, located in the area covered by the Fifteenth Revision. BLM approved the Sixteenth Revision on the following basis:

> The sixteenth revision enlarges the Nugget Formation participating area "A" 765.74 ares [sic] and is based on Sections 2(e) and 11 of the Painter Reservoir unit agreement. Section 2(e) states that all legal subdivisions of land within the participating area shall be 40 acre tracts or the nearest aliquot equivalent thereof, and Section 11 states that the participating area may be revised to include additional land necessary for unit operations. (The lands constituting the Sixteenth Revision will not be entitled to participation in unitized substances from the Nugget Formation and no royalty will be allocated to said lands, since the basis of the Sixteenth Revision is not due to the addition of lands proved to be productive in paying quantities.)

Champlin appealed that decision. 3/ In its statement of reasons (SOR), Champlin argues that BLM improperly interpreted and applied section 11 of

3/ Since Champlin had objected to action proposed to be taken (i.e., approval of the application), BLM should have treated the objection as a "protest" under 43 CFR 4.450-2 and ruled on it prior to taking final action on the application. BLM also failed to serve a copy of the Sept. 30, 1985, decision on Champlin despite its knowledge of Champlin's interest in action on the application.

the Unit Agreement when approving the revisions of the participating area. Champlin recognizes that the participating area may be revised to include additional land "then regarded as reasonably proved to be productive in paying quantities or necessary for unit operations." However, Champlin points out that section 11 also provides: "It is the intent of this section that a Participating Area shall represent the area known or reasonably estimated to be productive in paying quantities." Champlin asserts that "[t]here is no dispute that the tracts in question are non-productive, have never been produced and are not nor have ever known to be underlain by unitized substances" (SOR at 2).

Champlin agrees with and relies upon a letter to Chevron from the Wyoming Oil and Gas Commission (Commission), dated October 24, 1985, which joined Champlin in protesting the revisions proposed by Chevron. In its letter, the Commission also emphasizes the fact that the lands proposed for addition to the participating area were not productive:

> As clearly shown on Chevron's exhibits, all of the acreage to be brought in by the subject revisions is below the oil-water contact. In past revisions, the main reason for said revisions was that field development drilling had proven up acreage above the oil-water contact, thereby reasonably showing that the "new" acreage blocks were underlain by productive Nugget pay. Now, however, this latest series of revisions seeks to assign participation to acreage which is not underlain by productive Nugget pay. In particular, the proposed Fourteenth Revision would assign participation to the SW 1/4 NE 1/4 NW 1/4 of section 31, which is between 140 and 540 feet below the OWC. Chevron's reason for including the tract is that the BLM has requested inclusion because the bottomhole location of water injection well 11-31B "will result in improved hydrocarbon recovery." The BHL of 11-31B is about 400 feet away from the Fourteenth Revision's "new" surface acreage and is above the OWC. Further, the surface projection acreage of the BHL has already been included in previous revisions based on reasonably proven productive Nugget interval. The same objection applies to the Fifteenth Revision's "new" acreage (SE 1/4 SE 1/4 NE 1/4 section 30). [Emphasis in original.]

In agreement with the Commission's analysis, Champlin concludes that "[t]here is no basis, either under the Unit Agreement or BLM regulations, for expanding a Participating Area in this manner. Nonproducing acreage should not share equally with producing acreage" (SOR at 3).

The Commission further stated in its October 24, 1985, letter that "[i]f the proposed Fourteenth and Fifteenth Revisions are approved, * * * a very bad precedent will have been set that allows non-productive acreage to share equally with productive acreage." It then suggested that the Fourteenth and Fifteenth Revisions should be handled in the same manner as Chevron proposed for the Sixteenth Revision, i.e., include the new acreage in the participating area, but with no participation factor. However, Champlin disagreed with that proposal, stating "that such a solution would be inconsistent with

the requirements of both the Unit Agreement and BLM regulations." Champlin concludes that "[t]he only procedure which will satisfy these requirements would be to deny the Application, and grant special use permits for specific surface use, such as the injection wells, where appropriate" (SOR at 3).

[1] Our resolution of this appeal requires that we interpret the critical language of section 11 of the Unit Agreement:

> The Participating Area or Areas so established shall be revised from time to time, subject to like approval, to include additional land then regarded as reasonably proved to be productive in paying quantities or necessary for unit operations, or to exclude land then regarded as reasonably proved not to be productive in paying quantities and the schedule of allocation percentages shall be revised accordingly. * * *
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> It is the intent of this section that a Participating Area shall represent the area known or reasonably estimated to be productive in paying quantities; * * *. [Emphasis added.]

In its application for approval of the revisions to the participating area, Chevron states that "[t]he proposed Fourteenth and Fifteenth Revisions are predicated upon the consideration that water injection into the Nugget Formation * * * will result in improved hydrocarbon recovery * * *." Chevron does not assert that the acreage to be added to the participating area by the Fourteenth and Fifteenth Revisions are "regarded as reasonably proved to be productive in paying quantities" within the terms of section 11. Champlin complains that approval of these two revisions assigns participation in unitized substances, and allocates royalties, to acreage not underlain by "productive Nugget pay" (SOR at 3). BLM's decision does not state this directly, but does state that the land added to the participating area by the Sixteenth Revision will not be entitled to participation in unitized substances from the Nugget Formation and will not receive royalty allocation, "since the basis of the sixteenth revision is not due to the addition of lands proved to be productive in paying quantities." The implication, as Champlin concludes, is that the Fourteenth and Fifteenth Revisions will participate in the unitized substances and receive royalty allocation.

With regard to the Fourteenth and Fifteenth Revisions, the instant case involves the question whether a participating area may be revised to include acreage for a water injection well, where admittedly the lands are not known or reasonably proved to be productive of unitized substances in paying quantities.

This Board has not previously addressed this precise question. As a preliminary matter, we note that BLM revised the regulations governing onshore oil and gas unit agreements on June 10, 1983 (48 FR 26763). When the Unit Agreement involved herein was signed in 1977, 30 CFR 226.2(i) defined "participating area" to mean "[t]hat part of a unit area to which production is allocated in the manner described in a unit agreement." Also, section 11 of the Model Unit Agreement in effect in 1977, found at 30 CFR

226.11, did not provide for revision of the participating area to include lands "necessary to unit operations." BLM asserts in a memorandum dated January 14, 1986, that section 11 of the Model Unit Agreement was revised in 1982 to include the phrase "or which are necessary for unit operations" to reflect actual unit agreement language. 4/ In fact, the Unit Agreement includes such language.

The proposed amendments to the regulations governing unit agreements, dated June 10, 1982, modified the definition of "participating area" to mean "[t]hat part of a unit area which is considered reasonably proven to be productive of unitized substances in paying quantities or which is necessary for unit operations and to which production is allocated in the manner prescribed in the unit agreement." 47 FR 25252 (emphasis added). Similarly, the first paragraph of section 11 of the Model Unit Agreement included the phrase "or which are necessary for unit operations" in describing when revisions to the participating area to include additional lands are appropriate (43 CFR 3186.1). However, the second paragraph of section 11 stated that "[i]t is the intent of this section that a participating area shall represent the area known or reasonably proved to be productive of unitized substances in paying quantities * * *." Id. In the preamble to the final rule, BLM noted that "[o]ne commenter identified an inconsistency between the first and second paragraphs of this section." 47 FR 26765 (June 10, 1983). BLM agreed with this comment and amended the proposed section 11, explaining as follows:

> While the majority of participating areas include only those lands which are reasonably proved productive of unitized substances in paying quantities, some units require other land which is critical to unit operations to be included in a participating area. For example, these other lands may include those upon which an injection well is located. Therefore, to remove the ambiguity, the phrase "* * * which are necessary for unit operations" has been added to the second paragraph. [Emphasis added.]

4/ This memorandum was prepared by BLM following the receipt of Champlin's appeal and was part of the casefile transmitted to the Board by BLM. It was a synopsis of the chronological events leading to Champlin's appeal. When this document was discovered during review of the casefile for purposes of decision, it appeared that it had not been served on Champlin, as required by 43 CFR 4.22(b). In accordance with 43 CFR 4.27(b), the Board considered the memorandum to be an ex parte communication and by order dated Aug. 5, 1987, completed service of the memorandum on Champlin and allowed time for response. Champlin filed a timely response on Sept. 9, 1987. Also on Sept. 18, 1987, the Board received a letter from the Wyoming Oil and Gas Conservation Commission supporting Champlin's position. That letter showed that a copy was sent to BLM. The Commission has not sought intervention in this appeal nor has it requested status as an amicus curiae. In the absence of any objection, the letter has been included as part of the record in this case.

Thus, consonant with the current version of the regulations at 43 CFR Part 3180 5/ governing onshore oil and gas unit agreements, a revision to the participating area may include lands upon which an injection well is located. Such a revision must meet the prerequisite that the lands proposed for addition are "necessary for unit operations."

The question is whether the Unit Agreement, approved in 1977, is subject to the current regulations. We conclude that it is. Section 1 of the Unit Agreement expressly states that

> [t]he Mineral Leasing Act of February 25, 1920, as amended, supra and all valid pertinent regulations, including operating and unit plan regulations, heretofore issued thereunder or valid, pertinent and reasonable regulations hereafter issued thereunder are accepted and made a part of the agreement as to Federal lands, provided such regulations are not inconsistent with the terms of this agreement * * *.

The Unit Agreement provides in paragraph 1 of section 11 that a participating area may be revised to include those lands necessary for unit operations, with the clear implication being that such lands need not be proven productive of unitized substances. We conclude that the absence of the phrase "or necessary for unit operations" in paragraph 2 of section 11 of that Agreement does not require that all additions to a participating area be proved to be productive in paying quantities. We reach this conclusion for two reasons. First, we do not deem it appropriate to construe the second paragraph of section 11 as negating the alternative language specifically included in the first paragraph. Second, the regulations now in effect, specifically incorporated as part of the Unit Agreement by section 1, provide that the participating area may be revised to include acreage which is "necessary for unit operations." There is, therefore, no question that lands upon which injection wells are located may, under section 11 of the Unit Agreement and 43 CFR 3186.1, be considered "necessary for unit operations." 6/ However, it must

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5/ The regulations governing onshore oil and gas unit agreements were redesignated from 30 CFR Part 226 to 43 CFR Part 3180 effective Aug. 12, 1983. 48 FR 36587.

6/ The importance of the repressuring technique in oil and gas production was recognized by the court in Marathon Oil Co. v. Kleppe, 556 F.2d 982, 986 (10th Cir. 1977), which involved the interpretation of lease and regulatory provisions relating to the counting of water injection wells as if they were producing wells in connection with computing royalties under certain variable royalty rate oil and gas leases issued by the United States. Therein, the court stated:

"The use of water injection wells is a conservation measure designed to get maximum production from the oil producing wells in a given participating area. Both parties agree that water injection wells are permitted to be counted as oil producing wells, in determining the average daily production per well, in order to encourage lessees to drill as many injection wells as

be determined in this case whether the record supports BLM's approval of the Fourteenth and Fifteenth Revisions, finding those particular lands necessary for unit operations.

Chevron asserted in its application for the Fourteenth and Fifteenth Revisions to the participating area that the water injection wells would improve recovery of unitized substances. BLM represented in its January 14, 1986, memorandum that "all parties involved, Chevron, Champlin, BLM, and the Wyoming Oil and Gas Conservation Commission (WOGCC) agreed that injection wells were necessary for unit operations."

In its response received September 9, 1987, Champlin disagreed with that representation stating:

> A representative of Champlin was not present at the meetings between BLM and the Unit Operator and it is at a loss to know when it agreed that the injection wells were necessary for Unit operations. Its lack of agreement to a finding that such wells were necessary for unit operations is clearly evidenced by the written objections of Champlin to Chevron, dated July 16, 1985, * * *.
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> It is submitted that the record of the Rock Springs BLM action on the revisions of the participating areas is not supported by any competent geological or engineering evidence that improved hydrocarbon recovery will result by the disposal of produced salt water into the Nugget formation, by the injection wells in question. Unless there is improvement in hydrocarbon recovery by the disposal of salt water into the producing formation, then the injection and disposal of the produced salt water into the Nugget formation is not necessary for unit operations. At best, the record shows that the disposal of produced water by injection into the Nugget formation is a desirable method of disposal of the water, but such method is not necessary to the success of the unit operations. The distinction between necessary and desirable has been overlooked by the Rock Springs BLM Office.

We agree with Champlin. The record does not contain evidence to support the conclusion that the lands included in the Fourteenth and Fifteenth Revisions are necessary for unit operations. As pointed out by Champlin, the fact that injection of produced water is a desirable method for disposal of the water does not establish that such injection enhances the recovery of unitized hydrocarbons and is therefore necessary for unit operations. In the

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fn. 6 (continued)
will efficiently contribute to increased production. Both also agree that the injection wells in these basins are located at points which result in the maximum and most efficient recovery."

In this case there is disagreement over the necessity for the injection wells.

absence of evidence in the record that water injection has improved or will improve hydrocarbon recovery in the unit, we must find that BLM has failed to provide a rational basis for its determination regarding the Fourteenth and Fifteenth Revisions.

We turn to BLM's determination on the Sixteenth Revision. The purported reasons for inclusion of the 765.74 acres in the Sixteenth Revision were (1) to include the surface locations of the wells in the Fourteenth and Fifteenth Revisions within the Sixteenth Revision and (2) to establish the participating area on a 40 acre tract basis. Chevron in its application and BLM in its decision cited sections 2(e) and 11 of the Unit Agreement as the authority for the revision. BLM stated: "Section 2(e) states that all legal subdivisions of land within the participating area shall be 40 acre tracts or the nearest aliquot equivalent thereof." Contrary to that statement, section 2(e) does not specifically include such a requirement. Section 2(e) relates to elimination of acreage from a participating area. 7/ While it does limit eliminations to 40 acre legal subdivisions, it does not govern the acreage to be included in participating areas. Section 11 covers that.

Section 11 provides in relevant part:

> Upon completion of a well capable of producing unitized substances in paying quantities or as soon thereafter as required by the Supervisor, the Unit Operator shall submit for approval by the Supervisor a schedule, based on subdivisions of the public land survey or aliquot parts thereof, of all land then regarded reasonably proved to be productive in paying quantities; all lands in said schedule on approval of the Supervisor to constitute a Participating Area, effective as of the effective date of this Unit Agreement. [Emphasis added].

7/ Section 2(e) provides as follows:

"(e) All legal subdivisions of lands (i.e, 40 acres by Government survey or its nearest lot or tract equivalent; in instances of irregular surveys unusually large lots or tracts shall be considered in multiples of 40 acres or the nearest aliquot equivalent thereof), no parts of which are entitled to be in a participating area on or before the fifth anniversary of the effective date of the first initial Participating Area established under this Unit Agreement, shall be eliminated automatically from this Unit Agreement, effective as of said fifth anniversary, and such lands shall no longer be part of the Unit Area and shall no longer be subject to this agreement, unless diligent drilling operations are in progress on unitized lands not entitled to participation on said fifth anniversary, in which event all such lands shall remain subject hereto for so long as such drilling operations are continued diligently, with not more than 90 days' time elapsing between the completion of one such well and the commencement of the next such well. All legal subdivisions of lands not entitled to be in a Participating Area within ten years after the effective date of the first initial Participating Area approved under this agreement shall be automatically eliminated from this Agreement as of said tenth anniversary."

Section 11 does not specifically require the inclusion of legal subdivisions of a minimum of 40 acres. Rather participating areas are limited only to those lands (described by aliquot parts) reasonably proved to be productive in paying quantities or, as further described in section 11, "necessary for unit operations."

Neither of the cited Unit Agreement provisions supports BLM's conclusion regarding the acreage included as the Sixteenth Revision, except to the extent that section 11 allows the inclusion of land "necessary for unit operations." However, the record does not reveal a rational basis for concluding that the lands are necessary for unit operations. 8/

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is set aside and the case remanded.

Bruce R. Harris
Administrative Judge

We concur:

Wm. Philip Horton
Chief Administrative Judge

R. W. Mullen
Administrative Judge.

8/ BLM stated in its decision that because the Sixteenth Revision covered lands which were not productive in paying quantities, those lands would not be entitled to participation in unitized substances or to royalty allocation. However, the question raised by that determination is if those lands are "necessary for unit operations," are they not entitled to participation and royalty allocation.